United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

No. 76-7356

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

BP/S

IN RE: MASTER KEY ANTITRUST LITIGATION

EXXON CORPORATION, ESSO EASTERN, INC., EXXON PRODUCTION RESEARCH COMPANY, ESSO EXPLORATION, INC., ESSO INTER-AMERICA, INC., JAYVEN, INC., GILBARCO, INC., EXXON NUCLEAR COMPANY, INC., and EXXON RESEARCH & ENGINEERING COMPANY, *Appellants*.

Consolidated Appeals from the United States District Court for the District of Connecticut

BRIEF FOR CLASS MEMBERS-APPELLANTS

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August 17, 1976

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D. C.

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IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket Nos. 76-7356 and 76-7379 *

IN RE: MASTER KEY ANTITRUST LITIGATION

EXXON CORPORATION, ESSO EASTERN, INC., EXXON PRODUCTION RESEARCH COMPANY, ESSO EXPLORATION, INC., ESSO INTER-AMERICA, INC., JAYVEN, INC., GILBARCO, INC., EXXON NUCLEAR COMPANY, INC., and EXXON RESEARCH & ENGINEERING COMPANY, *Appellants.*

Consolidated Appeals from the United States District Court for the District of Connecticut

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BRIEF FOR CLASS MEMBERS-APPELLANTS

PRELIMINARY STATEMENT

Class members Exxon Corporation, *et al.* ("Objectors"), appeal from final orders (A946; A1022)[1] approving separate partial settlements of these class actions negotiated by

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* On the stipulation of the parties, these appeals were consolidated on August 5, 1976 pursuant to Rule 3(b), Fed.R.App.P.

[1] All "A" references are to the two-volume Appendix being filed herewith.

Plaintiffs' Liaison Counsel and two of four co-defendants, Emhart Corporation ("Emhart") and Ilco Corporation ("Ilco").[2] Plaintiffs brought suit under Section 4 of the Clayton Act, 15 U.S.C. § 15, against Emhart, Ilco, and non-settling defendants Sargent and Company ("Sargent") and Eaton Yale & Towne, Inc., predecessor to Eaton Corporation ("Eaton"), for alleged violations of Section 1 of the Sherman Act, 15 U.S.C. § 1.

On June 14, 1976, the Honorable M. Joseph Blumenfeld of the District of Connecticut entered a brief Memorandum of Decision approving a $7.5 million settlement of all classes' claims against Emhart (A837-A840). The Emhart settlement agreement (A1030) included an arbitrary 80%-20% plan of allocation which was not grounded on any credible evidence in the record of the June 2, 1976, "fairness hearing": Eighty percent of the Emhart settlement proceeds was reserved for the public-body classes to the detriment of the private-entity class to which the remaining twenty percent was allocated (A1034). This discriminatory allocation provision was agreed to on behalf of the private-entity class—of which Objectors are members—by counsel who had a conflict of interest because of simultaneous representation of public-body class members.

On June 28, 1976, Judge Blumenfeld approved without opinion an $85,000 compromise of all claims against Ilco (A870). Under the terms of the agreement (A871-A880), the proceeds were to "be used to reimburse common litigation expenses incurred by Settling Plaintiffs" (A875-A876). On a transaction basis comparable to the Emhart compromise, Ilco would have paid $950,000 in settlement (A919), but Plaintiffs' Liaison Counsel purportedly agreed

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[2] Wherever feasible, the appellants will be referred to as "Objectors", and appellees as "Plaintiffs Liaison Counsel", "Emhart" and "Ilco", in accordance with the provisions of Rule 28(d), Fed.R.App.P.

to the $85,000 settlement because of the "present poor financial condition of Ilco" (A919).

On June 29, 1976, the District Court entered an Order of Approval of Settlement and Final Judgment of Dismissal of Emhart Corporation With Prejudice (A946-A950) pursuant to Rule 54(b), Fed.R.Civ.P.; on July 12, 1976, the District Court entered an Order of Approval of Settlement and Final Judgment of Dismissal of Ilco Corporation With Prejudice (A1022-A1025) pursuant to Rule 54(b). Objectors timely appealed from both of these final orders under Section 1291 of the Judicial Code, 28 U.S.C.

Objectors do *not* challenge the amount of the Emhart settlement or the transaction basis upon which Ilco would have paid an amount in settlement comparable to that paid by Emhart.

THE ISSUES PRESENTED FOR REVIEW

1. Whether the District Court erred in summarily approving on a wholly inadequate record the arbitrary and discriminatory 80%-20% allocation provision of the Emhart settlement agreement negotiated by counsel with conflicting loyalties.

2. Whether the District Court erred in summarily approving on a wholly inadequate record the Ilco settlement proposal which is less than 10 percent of the amount which it would have paid on a transaction basis comparable to the Emhart compromise, and when the settlement agreement provided that the proceeds were to be used to defray litigation expenses incurred by plaintiffs' counsel.

STATEMENT OF THE CASE

Much of the essential background is set forth in prior decisions,[3] including this Court's opinion in *In re Master*

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[3] *In re Master Key Litigation*, 507 F.2d 292 (9th Cir. 1974); *In re Master Key Antitrust Litigation*, 1975-1 Trade Cas. ¶ 60,377 (D. Conn. 1975), *appeal dismissed*, 528 F.2d 5 (2d Cir. 1975); *Amherst Leasing Corp.* v. *Emhart Corp.*,

Key Antitrust Litigation, 528 F.2d 5 (2d Cir. 1975). Hence, only a synopsis of this litigation is necessary to provide a framework for review of the limited issues raised in these consolidated appeals.

1. The Nature of the Case

In the wake of antitrust actions brought by the Department of Justice against Emhart, Ilco, Sargent and Eaton, sixteen private treble damage suits against these same four defendants were filed as class actions.

(a) The antecedent Government litigation

On July 11, 1969, the Government filed actions for injunctive relief against each of the defendants alleging violations of Section 1 of the Sherman Act, 15 U.S.C. § 1, in the sale and distribution of master key systems. Master key systems are basically interrelated lock and key "contract builders hardware" for doors and are designed to specifications for a particular building or complex such as offices, hospitals, hotels, apartments and similar multi-room structures. Generally, each system provides for a different key for each door; master keys for a group of doors; grand master keys for two or more groups of doors; and a great grand master key for all doors in the system. Extensions are provided and keyed into the system when the building or complex of structures is expanded.

The Government's complaints alleged that each of the defendants was a major manufacturer of hardware used in master key systems in the United States: Emhart was alleged to have had approximately 900 distributors and

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65 F.R.D. 121 (D. Conn. 1974); *In re Master Key Antitrust Litigation,* 1973-2 Trade Cas. ¶ 74,680 (D. Conn. 1973); *In re Master Key Antitrust Litigation,* 53 F.R.D. 87 (D. Conn. 1971); *In re Master Key Antitrust Litigation,* 320 F. Supp. 1404 (J.P.M.L. 1971); *Philadelphia* v. *Emhart Corp.,* 317 F. Supp. 1230 (E.D. Pa. 1971); *In re Master Key Antitrust Litigation,* 50 F.R.D. 232 (E.D. Pa. 1970).

sales exceeding $10 million in 1966; Sargent, approximately 175 distributors and comparable sales of $6 million; Eaton, approximately 200 distributors and $5 million in sales; and Ilco, approximately 150 distributors and sales of $4 million. (See the complaints in *United States* v. *Emhart Corp.*, Civil No. 13262 (D. Conn. 1969); *United States* v. *Sargent & Co.*, Civil No. 13263 (D. Conn. 1969); *United States* v. *Eaton Yale & Towne, Inc.*, Civil No. 13264 (D. Conn. 1969); and *United States* v. *Ilco Corp.*, Civil No. 13261 (D. Conn. 1969).)

In late 1969, Ilco entered into a consent decree with the Government. *United States* v. *Ilco Corp.*, 1969 Trade Cas. ¶ 72,904 (D. Conn. 1969). In early 1970, Emhart and Sargent also entered into consent decrees. *United States* v. *Emhart Corp.*, 1970 Trade Cas. ¶ 73,048 (D. Conn. 1970); *United States* v. *Sargent Corp.*, 1970 Trade Cas. ¶ 73,104 (D. Conn. 1970). After trial, in early 1972 the District Court found that Eaton had violated Section 1 of the Sherman Act and granted injunctive relief. *United States* v. *Eaton Yale & Towne, Inc.*, 1972 Trade Cas. ¶ 73,889 (D. Conn. 1972).

(b) The private treble damage actions

In February, 1970, plaintiffs filed two actions in the Eastern District of Pennsylvania, *Philadelphia* v. *Emhart Corp.* (Civil Action No. 70-352) and *Amherst Leasing Corp.* v. *Emhart Corp.* (Civil Action No. 70-494). Both complaints alleged that the four defendant-manufacturers conspired (a) to impose customer and territorial restrictions on their distributors, (b) to restrict bidding on construction projects to those distributors who prepared particular builders' hardware specifications, and (c) to restrict bidding on extensions to master key systems to the initial supplying distributor. Plaintiffs alleged that these practices eliminated inter- and intra-brand competition and stabilized prices at non-competitive levels.

On June 23, 1970, the District Court ruled that both of these suits could proceed as national class actions. *Philadelphia* v. *Emhart Corp.*, 50 F.R.D. 232, 236 (E.D. Pa. 1970). These and other complaints filed in various districts were transferred to the District of Connecticut either pursuant to Section 1404(a) of the Judicial Code, 28 U.S.C., or by the Judicial Panel on Multidistrict Litigation pursuant to Section 1407 for consolidated pretrial proceedings. *In re Master Key Litigation*, 320 F. Supp. 1404 (J.P.M.L. 1971). Judge Blumenfeld appointed Lee A. Freeman, Jr., counsel for plaintiffs in the 14 State class actions, and H. Laddie Montague, Jr., counsel for plaintiffs in both the *Philadelphia* public-body national class action *and* the *Amherst Leasing* private-entity national class action, as Co-Liaison Counsel for Plaintiffs (collectively, "Plaintiffs' Liaison Counsel") (A46).

Despite the previous certification of one national public-body class and one private-entity class, the Plaintiffs moved, *inter alia*, for certification of: (a) fourteen state-wide public-body classes, with each state attorney general as the class representative; (b) one national class of the remaining states and all of their county and local governmental authorities, with the City of Philadelphia as class representative; and (c) a national private-entity class of owners and builder-owners of hotels, motels, apartments and office buildings, with Amherst Leasing Corp. as class representative. The District Court granted plaintiffs' motions. *In re Master Key Antitrust Litigation*, 1975-1 Trade Cas. ¶ 60,377 (D. Conn.) *appeal dismissed*, 528 F.2d 5 (2d Cir. 1975).

Following these rulings, Emhart and Plaintiffs' Liaison Counsel reached a $7.5 million settlement in June 1975 (A1039). The record does not reflect when agreement was reached on the arbitrary 80%-20% allocation provision challenged in this appeal. As a result, however, the public bodies are guaranteed at least $6 million from the Emhart

settlement regardless of whether their purchases from the defendants (or any claims they might make against the settlement fund) would correspond to the premature allocation of the fund; in fact, it appears that the public-bodies demanded $6 million from the Emhart settlement (A682) and that the 80%-20% allocation was an arbitrary "bootstrap" attempt to meet their demands.

Early in 1976,[4] the $85,000 compromise with Ilco was reached. However, there is nothing in the record as to the origin of the provision reserving the Ilco proceeds "to reimburse common litigation expenses" (A875-A876).

2. The Relevant Proceedings Below

Separate proceedings were held below on the fairness of the Emhart and Ilco settlements.

(a) The Emhart settlement proceedings

The District Court's undated "Notice of Class Action And Partial Settlement With Respect To Litigation Involving Finished Hardware" was sent to class members on March 29, 1976 (A407-A419). This Notice of the Emhart settlement specifically provided in subparagraphs B.1, B.2 and B.3 that builder-owners of structures having master key systems manufactured "by *any* of the defendants" (emphasis supplied) could share in the settlement proceeds (A409).

The Notice described the proposed allocation of the settlement fund as follows:

> The settlement agreement provides that the fund shall be allocated among the classes as follows:
>
> The state-wide and national government classes: eighty (80%) percent.
>
> The private builder-owner class: twenty (20%) percent (A410).

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[4] When tendered to the District Court for approval, the Ilco settlement agreement was unexecuted (A879).

No basis for this 80%-20% "formula" was provided in the Notice: The class members were given *no* information as to the origin, true purpose of, or any rationale for this arbitrary allocation.

The Notice established a procedure and set dates (a) for electing to be excluded from the class, (b) for filing appearances through counsel, and (c) for filing a notice of intention to appear at the June 2, 1976, Emhart "fairness hearing" at which class members could "present evidence" (A410). On May 13, 1976 (A16), Objectors timely filed an appearance and the required notice of intention to appear (A441).

Plaintiffs' Liaison Counsel's Memorandum in Support of Settlement with Emhart Corporation was not filed until May 24, 1976 (A17). Further, in the course of the June 2, 1976 "fairness hearing", they filed and served a brief affidavit of Lee A. Freeman, Jr. (A588-A591), sworn to on May 27, 1976 ("Freeman Affidavit"), and a brief affidavit of Karol K. Gibbs (A592-A601) sworn to on May 28, 1976 ("Gibbs Affidavit"). Plaintiffs' Liaison Counsel also adopted (A677) Emhart's Memorandum in Support of Proposed Settlement . . . (A541).

Significantly, Emhart's Memorandum was directed almost entirely to justifying the *amount* of the $7.5 million settlement. Only the last few pages (in response to certain objections) mention the plan of allocation. After briefly referring to the "records of Emhart Corporation" from which the 80%-20% "formula" was purportedly "derived" (A566), *Emhart then referred in a footnote to the explanation of the 80%-20% allocation set forth in Plaintiffs' Liaison Counsel's Memorandum.* Emhart did not offer any evidentiary support at the "fairness hearing" for the 80%-20% allocation provision in the settlement agreement (A1034): Its counsel did not address the 80%-20% allo-

cation "formula" (A686-A690), and did not reply to the objections raised—all of which were addressed to this arbitrary allocation (A690-A716; A721-A730; A731-A733).

Emhart concluded its brief comment on this issue in its Memorandum by noting that "the plan of allocation has been approved by all representative counsel [*i.e., Plaintiffs' Liaison Counsel*]" (A568). In fact, Plaintiffs' Liaison Counsel's Memorandum states:

> There were several meetings and numerous discussions among *plaintiffs'* counsel prior to complete acceptance and filing of the settlement agreement. . . . These discussions [among plaintiffs' counsel] led to agreement on the amount of the settlement, *the allocation between public and private classes,* and distribution among the states . . . (A527). (Emphasis supplied.)

Thus, the arbitrary 80%-20% plan of allocation originated in an agreement among plaintiffs' counsel, and did not result from an analysis of the transactions or sales pattern of either Emhart or, more appropriately, the four jointly and severally liable defendants. Moreover, the only person to speak for the private-entity class in these negotiations represented both public-body and private-entity class members. The District Court itself noted this conflict of interest at the June 2, 1976, hearing (A684).

Confronted with the Freeman and Gibbs Affidavits submitted for the first time during the course of the "fairness hearing" on Wednesday, June 2, 1976, Objectors requested ten days in which to file a post-hearing memorandum. The District Court permitted Objectors effectively *one* working day in which to prepare and file their analysis of the belated support for an arbitrary allocation of a settlement fund which, with interest, approximates $8 million (A730).

On Friday, June 4, 1976, Objectors' post-hearing Memorandum was timely filed (A818-A835). Plaintiffs' Liaison Counsel moved to strike Objectors' Memorandum. Objectors filed a Reply demonstrating that Plaintiffs' Liaison Counsel failed to refute *any* substantive point raised by Objectors (A841-A845). Prior to receiving Objectors' Reply, the District Court overruled Objectors' contentions in its brief summary Memorandum of Decision approving the 80%-20% allocation (A837-A840), and dismissed as moot the motion to strike (A836).

On June 24, 1976, Objectors' Motion for Reconsideration of the District Court's approval of the Emhart settlement was timely filed (A852-A863), supported by an Affidavit of Robert J. Sheehan, Director of Economic Research of the National Association of Home Builders ("Sheehan Affidavit"), which cast doubt on the validity of the "data" submitted in support of the 80%-20% "formula" (A846-A851). Objectors' Motion for Reconsideration was summarily denied the following day (A19). Nonetheless, on June 28, 1976, Plaintiffs' Liaison Counsel responded (A864-A869), ironically contending, *inter alia*, that the data in the Sheehan Affidavit should have been submitted earlier. Other class members filed a Motion for Joinder in Objectors' Motion for Reconsideration dated June 24, 1976 (A951-A952) which was denied as untimely filed on August 3, 1976 (A955).

(b) The Ilco settlement proceedings

The Notice to the class of the pendency of these class actions mailed on March 29, 1976, did not mention that the Ilco settlement discussions were then apparently near completion (A399-A400). Unlike the individual notice of the Emhart settlement which was mailed to 18,000 members of the private builder-owner class alone (A511-A512), *partial* notice of the Ilco settlement was sent to only 180 private-entity class members (A888).

The Notice stated that the $85,000 settlement "has no relation to Ilco's sales but is based solely on its current financial condition" (A890):

> Ilco Corporation has presented to plaintiffs and to the Court facts evidencing that it is in extremely poor financial condition and that any judgment entered against it . . . [would be] wholly uncollectible . . . (A889).

The so-called "facts" purportedly "presented to plaintiffs and to the Court" by Ilco as to its "extremely poor financial condition" were not revealed to the class members. The Notice also stated:

> In addition, Ilco has represented that it is a wholly-owned subsidiary separate and distinct from its parent company, Unican Security Systems, Ltd., a Canadian corporation, and that as a matter of law, a judgment against Ilco in this litigation could not be enforced against Unican (A889-A890).

The Notice further provided: "The fairness and reasonableness of the amount of the settlement is subject to the approval of the Court" and a hearing was set for June 28, 1976, "to determine whether the proposed settlement of the pending class actions against Ilco Corporation is fair and adequate" (A890). The Notice specifically provided that any class member "subject to reasonable limitations by the Court [could] present evidence at the hearing" (A890).

The Notice informing the class of the Ilco settlement was mailed only two weeks prior to the June 28 "fairness hearing" (A905). On June 23, 1976, Plaintiffs' Liaison Counsel served a 6-page Memorandum supporting the Ilco settlement which presented *no factual analysis* of Ilco's so-called dire financial condition (A918-A923) but addressed the issue in only one conclusory paragraph (A919). Interestingly, plaintiffs devoted more space in their brief Memorandum to the proposition that the relatively small Ilco settlement should be used "to pay common litigation

costs" (A921-A922) than to justifying the concededly small settlement in compromise of the classes' claims.

At the June 28, 1976 "fairness hearing" Plaintiffs' Liaison Counsel offered no evidence supporting their conclusions that the $85,000 settlement was fair and adequate. To the contrary, they reaffirmed that their conclusions as to Ilco's claimed financial situation were based on the representations of Ilco (A978; A983), and admitted that they "did not go into the merits and into the financial condition" (A981).

At the "fairness hearing", Ilco served a 4-page Memorandum of Law on the Liability of a Parent Corporation for Debts or Acts of Subsidiary (A958-A961), which contains *no factual analysis* applying the law to the Unican/Ilco relationship. Ilco also submitted at the "fairness hearing" a 2-page affidavit of its Secretary, Henry B. Dewey (A963-A964), which states that he was advised by Ilco's trial counsel—his law partner—that during March, 1976, certain of Ilco's financial statements were provided to Plaintiffs' Liaison Counsel (A963).

By letter of June 16, 1976, Objectors requested all materials relied on by Plaintiffs' Liaison Counsel in concluding that the $85,000 Ilco settlement offer was adequate. Mr. Montague responded by letter of June 23, 1976, providing a copy of the brief memorandum of law *prepared by Ilco's counsel*. Mr. Montague further stated that Mr. Freeman had forwarded to counsel for *other* class members "all the financial material pertaining to Ilco which is in our possession". These financial statements were provided to Objectors two business days before the Ilco "fairness hearing". Their review immediately raised substantial questions about the Unican/Ilco relationship and were offered *by Objectors* as Group Exhibit 1 at the "fairness hearing" (A993). This is the *only* evidence in the record of that hearing.

Having no record before it, the District Court approved the Ilco compromise from the bench (A1006) after entertaining brief oral argument only (June 28, 1976, tr. 1-42).

3. The Dispositions Below

(a) The approval of the Emhart settlement proposal

On June 14, 1976, the Court entered a four-page Memorandum of Decision approving the Emhart settlement (A837-A840). The Court noted that there were no objections to the amount of the Emhart settlement, and that the only objections to the 80%-20% plan of allocation came from members of the private-entity class (A838).[5] Rather than making factual findings, the District Court attempted to refute Objectors' opposition by concluding that "it is not necessary or appropriate to engage in speculation concerning possible alternative allocations based on some other hypothetical circumstances" because "the proposed allocation is . . . based on the historical allocation of Emhart sales" (A838). Significantly, the District Court did not identify any business records maintained by Emhart in which an 80%-20% division of sales between public-bodies and private-entities can be found.

The District Court rejected Objectors' argument that rather than relying on the so-called "Emhart figures", the combined sales of *all* defendants should be considered: "[T]he most pragmatic response is that the combined sales figures are simply not available at this time, if such figures exist at all" (A839). The second reason for rejecting Objectors' contention was that "the Objectors have not demonstrated any reason to assume that the figures of the other defendants would differ materially from those presented

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[5] The fact that public-bodies did not oppose the plan of allocation supports Objectors' contentions that the gerrymandered 80%-20% "formula" was biased in favor of the public-body classes.

by Emhart" (A839).[6] In making this suggestion, the District Court apparently overlooked its own conclusion in the preceding sentence that the combined sales figures of all defendants were *not available* and may not have existed.

The District Court then conceded the merit of Objectors' contention that counsel who negotiated in behalf of the private-entity class had a conflict of interest: "[T]his Court does not ignore the apparent conflict, and . . . it will take steps to remedy the situation . . ." (A839).[7] However, since it was negotiated by counsel with a conflict of interest, the allocation provision of the settlement remains tainted.

Finally, the District Court stated that "after weighing the small number of class members who chose to object and the fact that . . . the costs of this litigation have been borne chiefly by the members of the public class, I conclude that the proposed settlement is both reasonable and fair" (A840). Hence, the District Court itself apparently doubted the accuracy of the 80%-20% formula but concluded that the public-body class should receive the benefit of any doubt. However, there were no findings as to whether, in fact, the "costs" of the litigation were borne by the public-bodies. Also this statement underscores the fact that the claims of the private-entity class may not have been vigorously presented because of counsel's dual representation of conflicting interests.

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6 The District Court ignored the fact that Plaintiffs' Liaison Counsel and *not Emhart*, presented the "Emhart data" purportedly supporting the 80%-20% plan of allocation.

7 Two months elapsed before the "steps" were taken (A1028-A1029). While this appeal brief was being drafted, Plaintiffs' Liaison Counsel reminded the Court by motion to take the promised "steps".

(b) The approval of the Ilco settlement proposal

There is no written decision or bench opinion articulating any findings as to the fairness and adequacy of the Ilco settlement proposal or supporting the District Court's refusal to require an evidentiary record despite the substantial questions raised. Accordingly, reference to the comments in open court is necessary to portray the District Court's summary ruling.

Objectors contend that the record is wholly inadequate for either the Court, Plaintiffs' Liaison Counsel, Objectors or this reviewing court to make an informed judgment as to Ilco's/Unican's financial responsibility (A984-A995). Despite (a) the fact that its own Notice to the class members scheduled an evidentiary hearing on the fairness and adequacy of the Ilco settlement proposal, and (b) the serious questions raised by class members, the District Court accepted the unsupported statements of counsel sponsoring the settlement as a sufficient basis for approval:

> OBJECTORS' COUNSEL: * * *
>
> . . . I would like to call a witness and ask some questions about how the settlement was reached and how the determination was made that $85,000 is a fair settlement for this class.
>
> THE COURT: Well, you've heard the statements made by counsel, have you not?
>
> MR. KING: I certainly have, your Honor, and I'd like to inquire into them (A984).
>
> * * *
>
> MR. KING: I received certain documents. I'm troubled by the financial statements and certain comments made therein, including by the auditing firm.
>
> And I'd like to interrogate Mr. Montague to find out what he has done on the basis of these financial documents. Did he accept them at face value or did he make any independent investigation.
>
> THE COURT: I'm not going to put him on the stand. I'll let him answer that.
>
> What did you do, Mr. Montague?

MR. MONTAGUE: * * *

Mr. Freeman and I jointly went over them in Chicago, and they were then submitted to Mr. Freeman's account.[8]

We then asked questions to Mr. Donelan [Ilco's counsel] and got his representations as he understood the situation—again telling us that he was not a financial analyst (A986). (Emphasis supplied.)

Ilco's own auditor had pinpointed serious questions of a critical nature, as recognized by Plaintiffs' Liaison Counsel, who attempted to shift the burden to Ilco: "The burden, I think, falls upon Ilco, if serious question is raised, to have independent audits of these questionable transactions" (A980). Ilco's counsel, however, stated, "I'm not an expert on the financial statements" (A971), and was unable to respond to the questions raised:

MR. DONELAN: * * *

I understand from the few moments that we've had in the lobby here this afternoon that they [counsel] have been diligent in their study and they have questions—some of which, not being an accountant . . . I cannot answer for this Court today (A971).

Apparently, the District Court itself was not familiar with Ilco's financial statements:

THE COURT: * * *

Is there anything to support that, you know, just gratuitous provision that you raise here as one which should have been investigated in depth by counsel for the plaintiffs? Is there any support at all for any suspicion of that kind?

MR. KING: Yes, your Honor.

THE COURT: What is it?

MR. KING: These are the financial statements audited by Peat, Marwick & Mitchell. For example, it's a let-

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[8] Plaintiffs' Liaison Counsel did not identify, much less supply an affidavit or report from this accountant *despite the Court's request* (A621).

ter of November 12, 1975 to Ilco's Board of Directors —an exception is made as to its opinion.

THE COURT: As to its opinion? In what respects?

MR. KING: As to the effect of certain related party transactions, and these are transactions involving sales to an affiliate, which is also owned by Unican in North Carolina (A989).

The District Court showed no concern about the questionable transactions recognized by all counsel at the hearing (A971; A978; A989; A995-A997):

THE COURT: Now, what sort of a question does it raise in your mind? Does it raise a question of fraudulent withdrawal of funds when you talk about related transactions with a parent corporation, or does it raise a question of whether those are for fair market or arm's length transactions?

MR. KING: *The accounting firm of Peat, Marwick & Mitchell called them less than arm's length transactions. And Mr. Freeman said he was concerned about fraud.* (Emphasis supplied.)

THE COURT: All right. Whatever they call them. What does it suggest to you, a fraudulent withdrawal of funds?

MR. KING: That suggestion comes to mind immediately. And Mr. Freeman said that he obviously was concerned about fraudulent siphoning off of assets. *They were his terms.* (Emphasis supplied.)

THE COURT: All right. What else?

MR. KING: The financial statements make it quite clear that substantial repayments of debt was made to the parent during the pendency of this lawsuit, as well as the fact that I think Mr. Freeman pointed out there was substantial transfers of inventory to this affiliated corporation (A990-A991).

* * *

It may well be, based upon the Peat, Marwick financial statements, that the parent here has, in fact, exer-

cised dominion and control over this subsidiary and that the parent, despite the general rule of law, is, in fact, liable in this case (A992).

Despite the serious questions which all counsel appeared to recognize, the District Court foreclosed the development of an evidentiary record on the critical issues raised by Ilco's own financial statements:

MR. KING: * * *

[M]ay I make a formal motion to present evidence here by calling Mr. Montague as a witness?

THE COURT: No sir, you may not call Mr. Montague as a witness (A993).

* * *

THE COURT: So it gets down to whether or not you object to the determination that it's all they can pay.

MR. KING: I think we need an evidentiary record to determine that, in light of the financial disclosures, and I'd like to move that this matter be referred to a Special Master under Rule 53—

THE COURT: Not a chance.

MR. KING: —where an evidentiary record can be made.

THE COURT: Not a chance (A1003-A1004).

The Court then summarily disposed of the matter:

THE COURT: Well, this is a motion to approve a proposed settlement.

MR. FREEMAN: Yes, your Honor.

THE COURT: So then, I'll grant that motion and that will require that you submit an agreement that is signed, and also a motion for entry of partial judgment, right (A1006)?

Counsel were apparently sufficiently concerned about the validity of the position they were sponsoring that the Ilco settlement agreement was unexecuted when tendered to the Court for its approval.[9]

STATEMENT OF THE FACTS

Although this litigation has been pending since early 1970, the facts in the record of the June 2 and June 28 "fairness hearings" relevant to the disposition of these appeals are sparse.

1. The Dearth of Factual Support for the Emhart Plan of Allocation

It is evident that Plaintiffs' Liaison Counsel first agreed that public-bodies would receive $6 million of the Emhart settlement, and then attempted to manipulate available data to support that arbitrary allocation.

(a) The "Emhart Data" does not support the 80%-20% "Formula"

In their 13-page Memorandum in support of the Emhart settlement (A523), Plaintiffs' Liaison Counsel devoted less than two pages to data purportedly supporting the 80%-20% plan of allocation (A533-A535). Moreover, the "Emhart data" presented in their Memorandum and Schedule "A" thereto was completely uninformative as to the nature of Emhart's sales.

As highlighted by the belatedly filed Gibbs Affidavit, which presented a so-called "analysis of [Emhart's] contract *orders*, by Dodge Project Classification" for the years 1965-1968 (A592; emphasis supplied), the Emhart records relied on are *not* contemporaneous sales records. Further, the Dodge Classification System is *not* designed to distinguish between sales to public versus private bodies,

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[9] In contrast, the Emhart settlement agreement was fully executed at the time it was presented to the Court for approval (A1030-A1042).

but rather to collect generalized data on the construction industry.

An analysis of Schedule "A" appended to Plaintiffs' Liaison Counsel's Memorandum and of the Exhibits A through F to the Gibbs Affidavit reveal that the figures taken from Emhart's Dodge Construction Contract forms were grossly distorted (See Sheehan Affidavit, ¶ 3; A847). For example, Plaintiffs' Liaison Counsel arbitrarily categorized all "Educational" and "Science" buildings, all "Hospital and Health Buildings", and all "Public (Other)" buildings under the public-body category.[10] As stated in the uncontroverted Sheehan Affidavit:

> 4. Exhibit 1 of the Gibbs Affidavit portrays that according to Dodge Project Classification, 78.1% of Emhart's sales were to public entities versus 21.9% to private entities. However, those classifications resulted from a manipulation of the Emhart data contained on the F. W. Dodge Company forms, and *these figures (i.e., 78.1% versus 21.9%) do not appear in the Emhart data* contained in Exhibits A-F of that Affidavit. For example, Exhibit 1 places all "Educational & Science Buildings", 51.8% of the total of Emhart's sales, and all "Dormitories" (2.2%), or 54.4% of the total, into the public sector, when official data of buildings in place reveals that a significant dollar volume of educational buildings in place were, in fact, in the private sector (A847). (Emphasis supplied.)

Because of the historical development of education in this country, a significant portion of Eastern educational institutions at both lower and university levels are proprietary.

Further, an analysis of the category "Hospitals and Health Buildings" alone reveals that this "Emhart data" is a wholly unreliable means of allocating sales between

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[10] This "Public (Other)" category included a substantial number of federal government buildings which are *not* included in the settlement.

public-bodies and private-entities. Plaintiffs' Liaison Counsel placed all "Hospitals and Health Buildings" orders in the public sector, but data compiled by the Department of Commerce reveals that a significant portion of hospital and institutional building is in the private sector. As stated in the Sheehan Affidavit:

> 5. The gerrymandered nature of the 80%-20% plan of allocation based on the manipulation of the Emhart data is aptly demonstrated by the classification as public buildings in Exhibit 1 of the Gibbs Affidavit of all buildings in Item 4 on the Dodge classification forms as "Hospitals and Health Bldgs." In fact, as shown by the following statistics, the latest published data reveals that of the years 1968 through 1970, for which data is available, most hospital construction was in the private sector:
>
> | | 1968 % | 1969 % | 1970 % |
> |---|---|---|---|
> | Percentage In Private Sector | 69 | 73 | 75 |
>
> (A847)

Objectors presented the foregoing analysis to the District Court (A827-A829; A846-A849; A854-A856), but it did not address or refute their contentions that the "Emhart data" did not support the 80%-20% "formula". No business records of Emhart supporting any allocation between public-body and private-entity purchases, much less the arbitrary 80%-20% "formula", were presented. This was highlighted by the Sheehan Affidavit:

> 7. Because the 80%-20% arbitrary classification was reached as a result of an arbitrary classification of Emhart's data contained in Exhibits A-F of the Gibbs Affidavit, my comparison of the claimed analysis of that data leads to two conclusions: (1) The 80%-20% allocation is wholly arbitrary and in conflict with available industry-wide data; and (2) *the 80%-20% allocation is not a true representation of Emhart's sales to the public versus the private sector* because

> of the arbitrary classification of significant categories of Emhart's orders according to the Dodge Project Classification as sales to public bodies when in fact significant portions thereof were undoubtedly sales by Emhart to private builder-owners (A849). (Emphasis supplied.)

The District Court's summary conclusion that the 80%-20% allocation was "based on the historical allocation of Emhart's sales" (A838) was clearly erroneous and premised solely on the arbitrary, self-serving assumptions of Plaintiffs' Liaison Counsel which have no record support and are contrary to the facts.

(b) The Dykeman study

The Dykeman Study presented at the June 2 "fairness hearing" by Plaintiffs' Liaison Counsel could not have been the basis for the 80%-20% plan of allocation because they did not know of this study until virtually *one year after* the settlement was reached in June 1975.[11] This was merely another "bootstrap argument" to justify the arbitrary plan of allocation.

Although Mr. Freeman himself executed the affidavit presenting the Dykeman Study to the District Court at the "fairness hearing", he stated: "We do not place reliance on that study" (A749). In their Memorandum opposing the 80%-20% allocation provision, Objectors addressed the inadequacies of the Dykeman Study (A823-A825), and this analysis is incorporated herein by reference in the event that in this appeal reliance is place on the Dykeman Study which was abandoned below.

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[11] In fact, confronted with the Dykeman Study for the first time during the course of the "fairness hearing", Objectors attempted to obtain the transcript of Mr. Dykeman's deposition taken in April 1976, but it had not yet been filed with the Court (A725; A749).

Mr. Freeman's belated offer of the Dykeman Study in an attempt to bolster the feeble support for the 80%-20% "formula" was a dispositive concession that even Plaintiffs' Liaison Counsel lacked confidence in the manipulated "Emhart data".

2. The Evidentiary Void in the Record of the Ilco "Fairness Hearing"

The evidentiary record of the June 28, 1976 "fairness hearing" on the Ilco settlement proposal is devoid of support for the compromise of the classes' claims for $85,000. Ilco's financial statements (A758-A817) demonstrate that the only record facts weighed heavily *against* approval of the settlement.

A November 12, 1975, letter from Peat, Marwick, Mitchell & Co. ("Peat, Marwick") transmitting Ilco's consolidated financial statements for the fiscal years ending June 30, 1974 and 1975, contains a *qualified opinion* (A759). Peat, Marwick could not determine the effect on Ilco's financial condition of certain "related party transactions" (A759). Further, Peat, Marwick specifically noted that Ilco's parent, Unican, had "established certain policies" controlling Ilco's day-to-day business with another Unican subsidiary, and the resulting less than "arms length" transactions may have affected Ilco's revenues (A759). Thus, Peat, Marwick declined to endorse Ilco's financial statements as fairly representing its financial condition (A759).

The notes to Ilco's financial statements further reveal the following activity during the pendency of this lawsuit:

> 1. In the fiscal year ended June 30, 1974, Unican Security Systems Corp. located in North Carolina, a subsidiary of Unican, and described as a "related party" or "affiliated company" of Ilco, completed construction at a manufacturing plant to which Ilco "began shipping inventory . . . at cost" (A765);

2. In fiscal 1974 sales of inventory by Ilco to its North Carolina affiliate "at a price approximating cost" amounted to $3.6 million, and is reflected in Ilco's financial statements as a transfer from inventory to amounts due from affiliated companies (A765; A778);

3. In fiscal 1974, Ilco repaid all debt and accrued interest payable to Unican amounting to $608,475 (A765);

4. In fiscal 1974, Ilco acquired from an unidentified affiliated company 4,620 shares of stock of another corporation at a total cost of $225,000 (A765);

5. In fiscal 1975, Ilco's parent Unican "adopted a policy with respect to transfers of goods from Ilco to the North Carolina affiliate which calls for such goods to be transferred at the lower of Ilco's cost or net realizable value to the North Carolina affiliate upon resale of finished products to Ilco when customer orders are received" (A767);

6. In fiscal 1975, Ilco paid the North Carolina affiliate fixed percentages established by its parent of the selling price received by Ilco from its customers (A767);

7. During fiscal 1975, payments by Ilco to its North Carolina affiliate amounted to 84% of the selling price received by Ilco, although Ilco bears all selling expenses, of which approximately $504,000 was transferred from the North Carolina affiliate (A767);

8. In fiscal 1975, sales of approximately $9.6 million by Ilco were shipped by the North Carolina affiliate and billed through Ilco (A767);[12]

9. Fiscal 1975 shipments of approximately $2.2 million from Ilco to the North Carolina affiliate were reflected in Ilco's financial statements as transfers from

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[12] Hence, the Ilco name still has value in the trade and this significant volume of sales demonstrates that it remains a distinct marketing asset. Ilco is only one of a number of Unican's subsidiaries and affiliates in the United States engaged in the distribution of locks, security devices, and related hardware.

inventory to amounts due from affiliated companies, and these transfers resulted in a loss of approximately $360,000 which has been charged to Ilco's operations in that year (A767);

10. Ilco pays its North Carolina affiliate a 5% processing fee on all orders shipped by the North Carolina affiliate (A773);

11. At the end of fiscal 1975, $2.3 million was due Ilco from "affiliated companies" (A760); and

12. In September 1975, Ilco, one of three defendants sued by a former officer and director alleging breach of contract and seeking actual damages of approximately $243,000, settled for $25,000 in cash and securities valued at $11,250 (A767).[13]

In summary, although the Ilco financial statements raise substantial questions concerning certain transactions undertaken at the direction of its parent, Unican, the record of the "fairness hearing" does not answer any of these questions.

ARGUMENT

Objectors do not oppose the amount of the Emhart settlement or a settlement with Ilco on a comparable transaction basis. However, it was reversible error for the District Court, on the basis of a wholly inadequate record, to approve either the arbitrary allocation provision of the Emhart settlement agreement or the Ilco settlement proposal in the fashion it was presented. Without any exposition of the District Court's reasoning in approving the Emhart and Ilco settlements and rejecting the views of objecting class members, meaningful appellate review by this Court has been materially impeded.

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[13] Unican does not identify the other defendants in the lawsuit, or describe the contract allegedly breached or the securities delivered in partial settlement.

Objectors' contentions can be briefly summarized as follows:

The Emhart Settlement—The amount of the Emhart settlement is not before this Court for review. However, the arbitrary allocation provision challenged in this appeal should be striken from the Emhart settlement agreement. The settlement proceeds should be distributed to all class members (public-body and private-entity alike) on the basis of claims grounded on actual purchases. This method of distribution will resolve the dilemma created by the conflict of interest of counsel who negotiated the discriminatory plan of allocation, as well as the legal and factual issues surrounding the "Emhart data."

Plaintiffs' Liaison Counsel's opposition to this eminently fair apportionment of the settlement proceeds constitutes a dispositive concession that they have no confidence that the "Emhart data" is a true and reliable measure of purchases actually made by the public-body class members, and this enhances the conflict of interest.

The Ilco Settlement—This Court should remand the Ilco matter for the establishment of an evidentiary record on the financial responsibility of Ilco/Unican, and all class members should receive direct notice of a bona fide "fairness hearing". In ruling on the adequacy and fairness of the Ilco settlement proposal, the District Court should be required to set forth findings of facts and conclusions of law. Finally, this Court should order that the provision of the Ilco settlement reserving the proceeds for plaintiffs' counsel be stricken as contrary to public policy.

I. THE STANDARDS AGAINST WHICH THE DISTRICT COURT'S DISPOSITIONS MUST BE EVALUATED

A. The District Court's Unsupported Summary Approvals Constituted an Abuse of Discretion

On appellate review, class action settlements are examined to determine if the District Court abused its discretion in granting approval. *Detroit* v. *Grinnell Corp.*, 495 F.2d 448, 454-455 (2d Cir. 1974); *Newman* v. *Stein*, 464 F.2d 689 (2d Cir. 1972), *cert. denied sub nom. Benson* v. *Newman*, 409 U.S. 1039 (1972); *West Virginia* v. *Chas. Pfizer & Co.*, 440 F.2d 1079, 1085 (2d Cir. 1971), *cert. denied sub nom. Cotler Drugs, Inc.* v. *Chas. Pfizer & Co.*, 404 U.S. 871 (1971). However, in *Merola* v. *Atlantic Richfield Co.*, 493 F.2d 292, 295 (3d Cir. 1974), the Court of Appeals recently elaborated on the abuse of discretion standard:

> Where a District Court errs as a matter of law by utilizing improper standards or procedures . . ., an abuse of discretion occurs . . . . Similarly, clearly erroneous findings of fact require reversal.

As pointed out in *Merola*, an error of law, of course, requires reversal even where the abuse of discretion standard applies. The District Court's reliance on the "Emhart data" was a substantial error of law: The defendants are jointly and severally liable in this conspiracy action, and data relating to the sales pattern of only one settling defendant is irrelevant to the allocation of the settlement proceeds.

Further, where witnesses are not heard, the provision of Rule 52(a) that "due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses" does not restrict the scope of appellate review. *United States* v. *O'Brien*, 273 F.2d 495, 497 (3d Cir. 1960). In *Dopp* v. *Franklin National Bank*, 461 F.2d 873, 879 (2d Cir. 1972) this Court stated: "This is not a case . . . where there was an evidentiary hearing below and the credibility

of witnesses played an essential part in the District Judge's determinations." *Accord, San Filippo* v. *United Brotherhood of Carpenters & Joiners,* 525 F.2d 508, 511 (2d Cir. 1975).

In *Kuhn* v. *Princess Lida of Thurn & Taxis,* 119 F.2d 704, 706 (3d Cir. 1941), in reversing the District Court, the Court stated that where there are no factual controversies which were resolved by the District Court, the appellate court can make its own conclusions and that "an incorrect conclusion by a trial court qualifies as a 'clearly erroneous finding' . . ." In *In re Leichter,* 197 F.2d 955, 957 (3d Cir. 1952), *cert. denied sub nom. Dworsky* v. *Leichter,* 344 U.S. 914 (1953), the Court warned: "[W]e have on previous occasions held that 'A finding of fact must have more substantial foundation than an intuition . . .'."

In this case, the District Court merely made summary rulings based on the few submissions of counsel,[14] and there were no factual findings supporting those conclusions.

B. The Standard of Approval of Class Action Settlements

Rule 23(e) specifically provides that a "class action shall not be compromised without the approval of the court." This language is mandatory, and the District Court is the guardian of the absent parties in a class action. *Norman* v. *McKee,* 431 F.2d 769 (9th Cir. 1970), *cert. denied sub nom. I.S.I. Corp.* v. *Myers,* 401 U.S. 912 (1971); *Zerkle* v. *Cleveland-Cliffs Iron Co.,* 52 F.R.D. 151 (S.D.N.Y. 1971). Accordingly, in *Grunin* v. *International House of Pancakes,* 513 F.2d 114, 123-124 (8th Cir. 1975), *cert. denied* 423 U.S. 864 (1975), the Court recently stated that "[u]nder Rule 23(e) the District Court acts as a fiduciary . . . of the ab-

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[14] The self-serving Freeman and Dewey affidavits were executed by counsel who have an interest in the outcome of these proceedings, and the Gibbs affidavit is from one of counsel's employees made at his direction (A592).

sent class members" and its approval must be tested against a standard of "reasonableness under the totality of the circumstances".

A recent treatise set forth the purpose of Rule 23(e) as follows: "The rule is designed to protect non-party class members from an unfair or unjust disposition of their claims . . . ." American Bar Association, *Antitrust Law Developments,* 322 (1975). Moreover, in remanding for an evidentiary hearing on the fee matter in *Grinnell, supra,* Judge Moore held that in the face of opposition from class members, "if for no other reason but to allay suspicion, the court should typically take pains to allow a complete airing of all objection." 495 F.2d at 470. *A fortiori,* when certain facets of a settlement itself are opposed, the court sitting in equity as a fiduciary should not take steps to preclude the airing of opposition on the record.

The appropriate standards to which a district court must adhere in ruling on settlement proposals in cases of this nature can be summarized as follows:

(1) The evidentiary record must be complete. *Protective Committee* v. *Anderson,* 390 U.S. 414, 424 (1968), *rev'g* 364 F.2d 936 (5th Cir. 1966); *Piccard* v. *Sperry Corp.,* 120 F.2d 328 (2d Cir. 1941), *aff'g* 36 F. Supp. 1006 (S.D.N.Y. 1941);

(2) the underlying facts must be fully disclosed to class members for their informed judgment. *United Founders Life Insurance Co.* v. *Consumers National Life Insurance Co.,* 447 F.2d 647 (7th Cir. 1971);

(3) the proponents of the settlement must bear the burden of demonstrating its reasonableness and fairness to all who will be affected by it. *Zerkle, supra; Norman, supra;* and

(4) the objectors to the settlement must be given a full opportunity for timely adversary discovery and the presentation of opposing evidence. *Grinnell, supra,* 495 F.2d at 462; *Weiss* v. *Chalker,* 55 F.R.D.

168 (S.D.N.Y. 1972); *Saylor* v. *Lindsley*, 456 F.2d 896 (2d Cir. 1972); *Girsh* v. *Jepson*, 521 F.2d 153 (3d Cir. 1975); *Greenfield* v. *Villager Industries, Inc.*, 483 F.2d 824 (3d Cir. 1973); *Glicken* v. *Bradford*, 35 F.R.D. 144 (S.D.N.Y. 1964).

Applying those standards to this case, the District Court abused its discretion when it shifted the burden to Objectors (A839; A993), on less than adequate notice, to refute the unsupported contentions put forth at the "fairness hearings" by those sponsoring the settlements. Only the proponents can present the Court with evidentiary material supporting the settlement, and only with the active assistance of the proponents can the court make the findings on which its approval of the settlement must be based. However, the District Court is not merely a "rubber stamp" for the proponents of the settlement, but must exercise independent and objective judgment to safeguard the interests of absent class members. *Greenspun* v. *Bogan*, 492 F.2d 375, 378 (1st Cir. 1974).

Additionally, in approving a class action settlement, the District Court must "set forth the reasoning supporting its conclusions". *Bryan* v. *Pittsburgh Plate Glass Co.*, 494 F.2d 799, 804 (3rd Cir. 1974), *cert. denied sub nom. Abate* v. *Pittsburgh Plate Glass Co.*, 419 U.S. 900 (1974). In *Protective Committee* v. *Anderson, supra*, the Supreme Court held that summary approval of settlements is error:

> It is essential, . . . that a reviewing court have some basis for distinguishing between well-reasoned conclusions arrived at after a comprehensive consideration of all relevant factors, and mere boilerplate approval phrased in appropriate language but unsupported by evaluation of the facts or analysis of the law. 390 U.S. at 434.

This requirement has been adopted by this Court, *Newman* v. *Stein, supra*, 464 F.2d at 692, and reaffirmed by the

Circuits which have considered the issue. *Grunin, supra,* 513 F.2d at 125, n.9; *Bryan, supra,* 494 F.2d at 804; *Greenspun, supra,* 492 F.2d at 378.

Additionally, although not in the context of an approval of a settlement, the Third Circuit recently addressed the guidelines to be followed by trial courts in discretionary matters in *Allis-Chalmers Corp.* v. *Philadelphia Electric Co.,* 521 F.2d 360 (3d Cir. 1975), relying on both *Protective Committee* v. *Anderson, supra,* and this Court's leading decision in *Gumer* v. *Shearson, Hammill & Co.,* 516 F.2d 283 (2d Cir. 1974). In *Allis-Chalmers,* the Court held that "a proper exercise of discretion" required the District Court "clearly to articulate the reasons and factors underlying its decision":

> We endorse the suggestion contained in *Gumer* as a most desirable practice. . . . [I]t will convey to litigants [or class members] the reasons for the court's decision and will afford the appellate court a meaningful basis for review. . . . 521 F.2d at 364.

Thus, this Court has held that the absence of findings alone may require reversal. *Dopp, supra,* 461 F.2d at 879, n.15.

The District Court's failure to articulate its reasons for approving the Emhart and Ilco settlements—particularly in the light of opposition from class members—requires reversal.

II. THE DISTRICT COURT ERRED IN APPROVING THE EMHART AND ILCO SETTLEMENTS ON WHOLLY INADEQUATE RECORDS

Although it did not articulate any findings with respect to the Ilco settlement, presumably the District Court's approval was premised on the assertions of counsel sponsoring the settlement who made reference to Ilco's financial

statements, the notes to which raise substantial questions which were not resolved. Nonetheless, Objectors were prevented from examining the sponsors of the conclusion that Ilco was insolvent and that Unican, its parent, was not responsible for its debts. Similarly, although the Emhart settlement containing the arbitrary allocation provision was agreed to one *year* prior to the Emhart "fairness hearing", Objectors were allowed but one *day* to respond to Plaintiffs' Liaison Counsel's affidavits served during the course of that hearing.

As a matter of law, these limitations imposed by the District Court constituted a clear abuse of discretion. In *Cohen* v. *Young*, 127 F.2d 721 (6th Cir. 1942), the Court reversed a District Court's approval of a class action settlement over the objection that no "proof" of the defendant's insolvency was made in *open court* before the class claims were compromised. The appellate court held that the District Court "in its approval of the compromise did not rely upon nor mention the statement of [the defendant] relating to his insolvency nor the auditors' report prepared in reference thereto", 127 F.2d at 725, but merely relied on the "advice of the lawyers in the case". This alone was reversible error, and the case was remanded for the introduction of further evidence on the defendant's claimed insolvency:

> [J]udgments and decrees which make findings of fact shall be founded on evidence. Thus it is an abuse of discretion to refuse to receive and consider evidence by which the court's discretion should be guided or controlled. 127 F.2d at 726.

In short, Rule 23 was adopted so that "the court may have the benefit of that broader information which comes from receiving advice as to the views of all parties concerned and from considering evidence proffered by them upon the relevant points of the case". 127 F.2d at 725.

In *Greenfield, supra,* the Court reversed and remanded a District Court approval of class action settlements because objectors were not given an adequate opportunity to explore the proposal: "[I]t is elemental that an objector at such a [fairness] hearing is entitled to an opportunity to develop a record . . . by means of cross examination and argument to the court." 483 F.2d at 833. Similarly, in *Girsh* v. *Jepson, supra* the Court reversed and remanded holding that the District Court had an "inadequate record" on which to conclude "that the proposed settlement was fair, adequate and reasonable". 521 F.2d at 157. The objector's "opportunity to participate effectively in the settlement hearing, through cross-examination and argument, was frustrated by the late filing of the affidavits upon which plaintiffs and defendants relied to support the fairness of the settlement". 521 F.2d at 157. The objector's "attorneys did not receive the affidavits submitted in support of the settlement until the day before the settlement hearing was held". 521 F.2d at 157. This dilatory submission of supporting papers was held to be one of the factors which "combined to deny [the objector] meaningful participation in [the fairness] hearing". 521 F.2d at 158.

This rule has been vigorously enforced by this Circuit. In the leading case of *Saylor* v. *Lindsley,* Judge Friendly held that the District Court failed to "protect the right [of objecting class members] to develop a record which might show that the settlement was improvident". 456 F.2d at 897. This Court reached this conclusion despite the fact that, unlike here, the objectors were given "two weeks in which to submit further papers" as well as "extensive affidavits" in opposition to the proposed settlement. 456 F.2d at 899. The Court held that the "settlement should not have been approved over [a class member's] opposition when there is such doubt whether there had been truly ad-

versary discovery prior to the stipulation of settlement and he was afforded no opportunity for any thereafter". 456 F.2d at 904.

This Circuit's policy governing disposition of these appeals was set forth by Judge Friendly in *Newman* v. *Stein, supra*:

> [A]ppellate courts have rejected approval of settlements where the trial court acted without sufficient facts concerning the claim, or failed to allow objectors to develop on the record facts going to the propriety of the settlement. 464 F.2d at 692. (Citations omitted.)

Approval of the settlement was affirmed after a full trial had been held and "neither objector complained that the district judge subsequently prevented development of any further facts relevant to the settlement." 464 F.2d at 693.

More recently, in the Court's landmark decision in *Grinnell, supra,* Judge Moore summarized this policy as follows:

> The rule in this Circuit provides that an approval of a class action settlement offer by a lower court must be overturned if that court acted 'without [knowledge of] sufficient facts concerning the claim' or if it 'failed to allow objectors to develop on the record facts going to the propriety of the settlement'. 495 F.2d at 462.

In *Grinnell*, the District Court set forth extensive and detailed findings of fact which demonstrated that it had reached a conclusion "only after a thorough investigation of all relevant facts". 495 F.2d at 464. While the District Court should not resolve issues to be decided at a trial on the merits in passing on the propriety of a settlement, it must nonetheless have "before it sufficient facts intelligently to approve the settlement offer".

495 F.2d at 462-463. In this case, the amount of the Emhart settlement or the amount that Ilco would have paid on a comparable basis are not in dispute: The facts and law relevant to the proper exercise of the District Court's discretion on the issues raised in this appeal would not have risked prejudgment of any controversy set for trial.

A brief review of the application by other District Courts within this Circuit of the principles governing approval of settlement proposals aptly demonstrates the error committed below. In *Percodani* v. *Riker-Maxson Corp.*, 50 F.R.D. 473 (S.D.N.Y. 1970), counsel recommended settlement of the plaintiffs' $12 million claims for $1.8 million because the defendant was purportedly unable to afford a larger payment. Despite the fact that the defendant had been repeatedly deposed and an extensive factual record had been developed, the District Court held that the proposal was not in the best interest of the plaintiff class and disapproved the settlement:

> [T]his court is particularly concerned by the lack of proof offered to it concerning the ability of defendant Riker-Maxson Corporation to pay a judgment against it more sizeable than the proposed $1,800,000 settlement. . . . [I]t is essential that more proof concerning it be offered. 50 F.R.D. at 478.

In *Fricke* v. *Daylin, Inc.*, 66 F.R.D. 90 (E.D.N.Y. 1975), the District Court was faced with a settlement which counsel supported because of the defendants' alleged insolvency. Lengthy depositions and massive document productions had been conducted, affidavits were submitted, and experienced counsel recommended approval. Five members of the plaintiff class numbering over 4,300 objected to the proposal. 66 F.R.D. at 91. Nonetheless, the District Court analyzed the terms and their fairness at length, 66 F.R.D. at 94-98, and decided that the proponents had not met their burden of supplying sufficient evidentiary facts on which

approval could be based. Specifically, the court stated that the conclusory affidavits which had been submitted to show the insolvency of the individual defendants "fail to satisfy the court" that approval of the settlement was in the best interest of the plaintiff class. 66 F.R.D. at 98.

Similarly, in *Weiss* v. *Chalker*, 55 F.R.D. 168 (S.D.N.Y. 1972), the District Court found "disturbing" the fact that fundamental questions of fact were "the subject of assertion and counter-assertion without proof". 55 F.R.D. at 171. Therefore, a special co-counsel was appointed for the limited purpose of conducting discovery for 90 days and informing the Court on the new facts and their bearing on the settlement. Thereafter, all counsel would have the opportunity to comment and reply.

In this case, there were not only substantial evidentiary voids in the records of both the Emhart and Ilco "fairness hearings", but the District Court was adverse to any suggestion that a complete record be established. The District Court prejudged the issues before it, as made clear by the comments made in chambers prior to the "fairness hearings" (A620-A621),[15] and viewed the "fairness hearings" specifically provided for in its Notices as *pro forma* exercises (A623).[16] *In Grinnell, supra*, this Court remanded a fee matter because "[c]ontrary to the terms of this notice" to the class members, the District Court "refused to hold an evidentiary hearing" and decided the matter "with only the benefit of oral argument and submitted papers to guide it, in spite of the fact that counsel for the appellants stated to the Court that he 'proposed to present evidence'." 495 F.2d at 472.

The inadequacy of the record in view of the opposition of objecting class members necessitates reversal of the

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[15] Objectors only received a copy of this transcript on August 12, 1976, as part of the materials requested by appellees for inclusion in the Appendix.

[16] The Court: "Some notice has to be given. The rules require it" (A623).

District Court's approval of the arbitrary allocation provision of the Emhart settlement agreement, and reversal of the approval of the Ilco settlement and a remand for the establishment of a record.

III. SUBSTANTIAL QUESTIONS OF LAW AND FACT WERE NOT RESOLVED BY THE DISTRICT COURT'S SUMMARY APPROVAL OF THE EMHART AND ILCO SETTLEMENT PROPOSALS

A. The Emhart 80%-20% Plan of Allocation

In approving the 80%-20% "formula" based on the "Emhart data" the District Court ignored its own Notice to the class members which provided that a builder-owner who purchased from *any* defendant could make a claim against the Emhart settlement proceeds (A399). This comports with the well-established rule that an antitrust claim is a tort action, *Chattanooga Foundry & Pipe Works* v. *Atlanta*, 203 U.S. 390 (1906), and that in this conspiracy action, the co-defendants are jointly and severally liable for the entire amount of the damages caused by the conspiracy. *Wainwright* v. *Kraftco Corp.*, 58 F.R.D. 9, 11 (N.D. Ga. 1973).

The joint and several liability of the defendants was conceded by Plaintiffs' Liaison Counsel in their supporting Memorandum (A523-A537). Because each defendant in a conspiracy case is liable for the total amount of damages, a partial settlement does not represent any single defendant's proportional share of the liability; the liability cannot be allocated because each defendant is liable for the entire claim. Accordingly, the fund should be allocated just as the entire liability would be, *i.e.*, according to the claims of the plaintiff classes against *all* the defendants. Otherwise, inequity will result when additional amounts are recovered by settlement or judgment against other defendants.

In *Wall Products Co.* v. *National Gypsum Co.*, 357 F. Supp. 832 (N.D. Cal. 1973), dealers of gypsum wallboard instituted antitrust actions against several manufacturers. Kaiser agreed to settle by tendering:

> $60,000 to all plaintiffs in settlement of plaintiffs' claims against Kaiser, and the parties to the settlement have agreed that from this total sum *there shall be allocated to each plaintiff an amount equal to the percentage that each plaintiff's recovery herein bears to the total recovery of all plaintiffs.* 357 F.Supp. at 834 n.1. (Emphasis added.)

Thus, because the defendants were jointly and severally liable, Kaiser's settlement was distributed on the basis of each dealer's pro rata share of the total recovery against *all* the defendants.

In *Wainwright, supra,* Better Maid, one of several defendants, settled and agreed to pay the plaintiffs $40,000. In assessing the settlement, the District Court remarked: "The 'covenant' states that the $40,000 is not related to or computed on the basis of Better Maid's sales of fluid milk to the plaintiff class. . . ." 58 F.R.D. at 11. The settlement could not properly be tested against the proportional sales of only the settling defendant, but instead was judged against the total claims sought by the plaintiff class. Likewise, recovery by settlement must also be allocated according to all the claims of the class, and the allocation of the Emhart fund between the public-body and private-entity classes should therefore be in proportion to the claims of each class against *all* the defendants.

The 80%-20% "formula" approved below is inherently inconsistent. If an allocation were to be based upon only sales made by Emhart, then logically only those class members who purchased from Emhart should receive the funds. However, class members who purchased from any defendant may share in the Emhart settlement funds (A399). Therefore, the share each class member may receive must be equal to the ratio of each member's claim

to the claims of all the members against all the defendants. Furthermore, the allocation of each settlement must be identical with the allocation of the entire recovery from all defendants; each class should receive the same total amount from four separate settlements as it would from one judgment equal in amount to the four settlements.

Moreover, no reliable data were submitted demonstrating that the 80%-20% "formula" does, in fact, comport to even Emhart's sales pattern. Section 1.46 of the *Manual for Complex Litigation* states: "*The apportionment of the total proposed settlement among the several classes requires reliable economic data. . . .*" (Emphasis supplied.) Here, the unsoundness of the "Emhart data" as support for the arbitrary Plan of allocation was demonstrated, *supra.*

In addition to the legal irrelevancy and lack of factual support for the "Emhart data", further aspersion is cast on the arbitrary allocation "formula" by the conflict of interest of counsel who agreed to it on behalf of the private-entity class. Because each of the two classes which counsel represented was seeking the greatest share possible of the $7.5 million fund, there was a disabling conflict of interest which indelibly taints the Emhart settlement as long as the allocation provision remains part of the settlement agreement.

The duty of an advocate forcefully to pursue the interests of his clients is critical in the context of class actions where conflicts of interest between class and counsel are an ever-present danger and counsel has an enhanced fiduciary duty to the class. *Greenfield, supra,* 483 F.2d at 832. In *Saylor* v. *Lindsley, supra,* 456 F.2d at 900-901, this Court noted in reversing the approval of a class action settlement: "There can be no blinking at the fact that the interests of the plaintiff in a [class action] and of his attorney are by no means congruent." Much criti-

cism has been voiced against attorneys in class actions, and in *Liebman* v. *J. W. Petersen Coal & Oil Co.*, 63 F.R.D. 684. 701 (N.D. Ill. 1974), the District Court gave the following admonition:

> Quick, cheap settlements, *conflicting representation of more than one class*, side deals for the payment by defendants of plaintiffs' counsels' fees, . . . have brought justifiable criticism of Rule 23 in action. (Emphasis added.)

Only by forbidding dual representation of conflicting interests can the courts "keep the standard of conduct for fiduciaries 'at a level higher than that trodden by the crowd'." *Woods* v. *City National Bank & Trust Co.*, 312 U.S. 262, 269 (1941). In *Bell* v. *Automobile Club of Michigan*, 18 F.R. Serv. 2d 1496, 1497 (E.D. Mich. 1974), the court disapproved dual representation of two classes: "[T]o have . . . the same attorneys represent both groups in the same action gives rise to significant conflicts of interest". The court stated that particularly because many class actions are settled, each class should be represented by disinterested counsel. Similarly, in *Philadelphia Housing Authority* v. *American Radiator & Standard Sanitary Corp.*, 323 F. Supp. 364, 377 (E.D. Pa. 1970), the court noted the conflict of interest problem flowing from dual representation of competing classes.

In *Hartford Hospital* v. *Chas. Pfizer & Co.*, 52 F.R.D. 131 (S.D.N.Y 1971), the District Court approved the division of the settlement proceeds because it was "the result of negotiations between counsel for the private hospitals and counsel for the Blue Cross plans." 52 F.R.D. at 137. And in *In re Gypsum Cases*, 386 F. Supp. 959 (N.D. Cal. 1974), the District Court attributed the resolution of interclass differences to the fact that "representative counsel for

each class was an attorney of record for only plaintiffs in the class he represented." 386 F. Supp. at 965.

When a provision of a settlement sponsored by counsel with a conflict of interest is in fact detrimental to members of that class, granting of approval constitutes an abuse of discretion. By reversal of the approval given below to the arbitrary allocation provision, this Court would remove the taint from the settlement flowing from counsel's dual representation of classes with conflicting interests. Also, the questions of law and fact raised by the "Emhart data" would then be moot.

In summary, there should be no premature allocation of the settlement proceeds until the class members—public and private alike—submit claims based on their actual purchasing experiences from all defendants.

B. Ilco's Claimed Financial Difficulty and the Responsibility of Its Parent, Unican

Plaintiffs' Liaison Counsel suggest that although on a transaction basis comparable to the Emhart settlement, Ilco should have paid $950,000, they agreed to an $85,000 compromise claims against Ilco because of its present financial difficulties and the fact that for all practical purposes, Ilco was judgment-proof (A919). However, the record is wholly incomplete on this issue.

The District Court's approval of very limited notice of the Ilco settlement proposal prejudged its adequacy and rendered meaningless the Ilco "fairness hearing" as was made clear by a conference in chambers (A613-A646). The fact that the Ilco settlement was relatively small necessitated, rather than militated against, full and complete direct notice to all who had received notice of the Emhart settlement. This is particularly so because the Notice stated that the Ilco "settlement funds will be used to defray

common litigation expenses incurred by plaintiffs" (A907-A908).

The cursory notice approved by the District Court does not comply with Rule 23 as it has been applied by the courts. In *Girsh* v. *Jepson, supra,* 521 F.2d 153, individual notice of a proposed settlement was sent to all stockholders of record as of three separate dates only: The proponents of the settlement contended that notice to all class members who had ever owned stock would have been prohibitively expensive. This contention was supported by a pro forma affidavit, alleging that "the best notice practicable" had been provided. The Court of Appeals strongly disagreed, and held that the requirements of Rule 23, as interpreted by the Supreme Court in *Eisen* v. *Carlisle & Jacquelin,* 417 U.S. 156 (1974) had not been satisfied. 521 F.2d at 157-158. The District Court below ignored the notice requirements, and thereby precluded many class members from deciding if they concurred in the proposed compromise of their claims against Ilco. As a result, it is impossible to determine whether the Ilco settlement proposal would have been vigorously opposed by other case members.

Viewed in the perspective of the less than adequate notice and the unsavory provision that the proceeds were to be reserved for plaintiffs' counsel, it is all the more surprising that both Plaintiffs' Liaison Counsel and defense counsel *disavowed* knowledge of Ilco's financial statements upon which they based their conclusion that $85,000 was a fair compromise of the classes' claims. This brings to mind Judge Will's warning in *Liebman, supra,* that Rule 23 is criticized because of "side deals for the payment by defendants of plaintiffs' counsels' fees". 63 F.R.D. at 701. In this Circuit, Judge Wyatt's comments in *Philadelphia* v. *Chas. Pfizer & Co.,* 345 F. Supp. 454, 471 (S.D.N.Y. 1972) are also apropos: Counsel for the class was chastised because while purportedly acting in the class' behalf "he

was negotiating an agreement by which defendants would pay his fees. This seems to involve some conflict of interest". The Court further warned: "[T]he procedure seems wrong in principle and ought to be discouraged. Moreover, however high-minded the parties may be, the appearances are frequently unfortunate." 345 F. Supp. at 471.

In addition, the District Court below articulated no reasons for its approval of the Ilco settlement, and there was no credible *factual* evidence of Ilco's claimed inability to pay a larger amount in settlement. Indeed, the Ilco financial statements reveal that its certified public accountants did not endorse the accuracy of these statements because of certain less than arm's-length transactions between Ilco, its parent Unican and its sibling subsidiaries.

The District Court made an even more fundamental error of law, however, by apparently deciding on an incomplete record that Unican, Ilco's parent, is not liable for the debts of its 94% owned subsidiary. This conclusion was presumably based on a four-page "legal memorandum" prepared by Ilco's counsel, and relied on by Plaintiffs' Liaison Counsel (A958-A962) which recites general principles of law without any factual link to the relationship between Ilco and Unican. The record is utterly devoid of facts to show that Unican is not liable for the obligations of its subsidiary precisely because of the exceptions cited in Ilco's own "legal memorandum".[17] For example, Ilco admits that in certain circumstances, courts will disregard separate corporate entities when: (1) The parent actively and directly participates in operations of the subsidiary; (2) the intercorporate relationship results in fraudulent or injurious consequences; (3) the subsidiary is an agent of the parent; or (4) the assets of parent and subsidiary are

[17] Ilco apparently overlooked a most frequently cited case listing the criteria for piercing the corporate veil. *See Steven* v. *Roscoe Turner Aeronautical Corp.*, 324 F.2d 157, 160-161 (7th Cir. 1963).

confusingly intermingled (A959-A960). Despite these admitted exceptions to the general rule, Ilco's "legal memorandum" does not set forth *any* facts to show that the Ilco/Unican relationship does not fit one of these exceptions.

The District Court itself prior to the "fairness hearing" requested that Plaintiffs' Liaison Counsel submit an affidavit from "whoever . . . investigate[d] from their standpoint what the financial condition of the company is and the . . . responsibility on the part of the parent company in Canada" (A621). That request was resisted, however, and the burden shifted to Ilco (A621), despite the Court's request for "some steps to test or verify the [claimed financial] condition [of Ilco]" (A622). Ilco's counsel stated that he had *agreed* to provide an affidavit from the Chairman of The Board of Ilco—who is also Chairman of Unican—that the two companies "are separate entities and are operating in that manner by him" (A619). Significantly, such an affidavit was never submitted, but rather Ilco's Counsel tendered an affidavit from his law partner, Mr. Dewey, despite the Court's specific warning against counsel for the parties submitting affidavits (A621), and thereby becoming witnesses for their clients.

Further, there appears to be a material discrepancy between the affidavit of Ilco's Secretary and information contained in documents Ilco filed with the Securities and Exchange Commission. The Dewey affidavit states that the 1972 "agreement for the purchase of Ilco stock by Unican did not provide for the assumption by Unican of any debts or liabilities of Ilco" (A964).[18] However, the Notes to Unican's consolidated financial statements for the year ending June 30, 1972, filed in the Boston Office of the Securities and Exchange Commission states:

> Concurrently with the acquisition of Ilco Corporation the company [Unican] issued 75,000 common shares

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[18] Neither the purchase agreement nor any other corporate records relating to Unican's purchase of Ilco were presented at the "fairness hearing".

> of the company at $4 per share in consideration for the purchase from another corporation of a note of $300,000 payable by Ilco Corporation. (Note 3.)

Hence, it appears that Unican may have, at least on a *selective* basis, agreed to pay certain debts of Ilco. Further, filings made by Unican as required by § 133 of the Canada Corporations Act reveal that Unican's financial statements set forth the following inconsistent statement as to Unican's potential liability for *this litigation:*[19]

> Legal counsel is unable to assess whether any of these actions have merit and [Unican] and counsel *are unable to determine what damages . . . may result from these actions.* (Emphasis supplied.)

Thus, while Ilco has claimed in this proceeding that its parent Unican has no responsibility for any liability arising out of this lawsuit, its parent Unican has not made such a disclaimer in audited financial reports filed with its own Government.

Unican's financial statements further reveal:

(1) On the date of its acquisition, Ilco provided Unican with $378,141 in working capital.[20]

(2) Unican acquired Ilco with the intent of closing out at least some of its operations:

> Concurrent with [Unican's] acquisition of Ilco Corporation, the subsidiary commenced to discontinue certain unprofitable products and product lines and to consolidate certain manufacturing operations.[21]

(3) In the year of its acquisition, Ilco contributed 24¢ net income per share (based on only 5 months of

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19 Notes to Consolidated Financial Statements, June 30, 1975, Unican Security Systems Ltd., p. 11.

20 Notes to Consolidated Financial Statements, June 30, 1972, Unican Security Systems Ltd., p. 6.

21 *Id.* at p. 6(b).

operations) to Unican's annual corporate net income per share of 50¢.[22]

(4) In 1973, Ilco paid its directors an average of $18,766 each. Other Unican subsidiaries paid their directors only $4,126 each.[23]

(5) In 1973, Unican built a new facility in North Carolina to which it transferred much of Ilco's manufacturing equipment.[24]

The chronology of Unican's relationship with Ilco is likewise instructive: In 1969, the Government sued Ilco; in 1969, Ilco settled with Government; in 1970, the classes sued Ilco; and in 1972, Unican acquired Ilco. Despite the undeniable fact that in 1972 Unican purchased a profitable, going concern, with substantial liquid and physical assets and profit potential, Ilco is now held out to be a bankrupt shell. If Ilco did engage in antitrust violations prior to 1969, the illegal profits it thereby earned were a part of the assets acquired by Unican in 1972. Now, however, Ilco disingenuously contends that Unican acquired only Ilco's assets, not its liabilities.

In *United States* v. *Van Raalte Co.*, 328 F. Supp. 827 (S.D.N.Y. 1971), Judge Gurfein refused to dismiss a complaint, holding that although the offending corporation had been purchased and denuded of assets by its parent, the liability of the acquired firm for violating a Federal Trade Commission order did not cease upon its acquisition. Here too, Unican had admittedly had knowledge of the *pending* antitrust suits against Ilco, but attempted to acquire only its assets and eschew its liabilities, although obviously Unican is bound by the consent decree by which Ilco settled the Government antitrust suit.

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22 *Id.* at p. 6(k).

23 Notes to Consolidated Financial Statements, June 30, 1973, Unican Security Systems Ltd., p. 19.

24 Notes to Consolidated Financial Statements, June 30, 1974, Unican Security Systems Ltd., p. 7.

In *Hoche Productions* v. *Jayark Films Corp.*, 256 F. Supp. 291 (S.D.N.Y. 1966), the defendant corporation contended that although it had admittedly acquired all the capital stock of another corporation, it had taken by assignment only the assets of that corporation. The result of this arrangement was a breach of contract action when the defendant refused to honor its contractual obligations to the plaintiff. Judge Bonsal rejected such an inequitable arrangement: "The Court will not permit [the defendant] to escape liability for [the acquired company's] transactions . . . and holds that [the defendant] is liable . . . ." 256 F. Supp. at 296.

The factual situation in *Bernadin* v. *Midland Oil Corp.*, 520 F.2d 771 (7th Cir. 1975) is much like the one under review. In *Bernadin*, the Seventh Circuit affirmed the district court's finding that a parent should be held liable for the debts of a subsidiary which the parent had liquidated, concluding that such a result "was proper at law and in equity":

> To permit [the parent] to escape [the subsidiary's] creditors by retaining [the subsidiary] as a shell would clearly be unequitable and unjust. Factors such as the stock ownership and the decision to liquidate and maintain a shell establish a situation where the corporate veil should be pierced. 520 F.2d at 775.

Likewise, in *Knapp* v. *North American Rockwell Corp.*, 506 F.2d 361 (3d Cir. 1974), an acquiring company was held liable for injuries caused by a machine manufactured by the acquired company *before* the acquisition, even though the acquired company continued to exist as an independent corporation. The concurring opinion in *Knapp* stated: "[T]ort claimants need protection against attempts by ongoing businesses to avoid liability through transfer of their operations to another legal entity." 506 F.2d at 371.

In the present case, despite their fiduciary duties, neither the District Court nor Plaintiffs' Liaison Counsel properly protected the interests of absent class members. At a minimum, a *factual* inquiry is essential to determine the true relationship between Ilco and Unican.

CONCLUSION

For all of the foregoing reasons, (a) the District Court's order approving the arbitrary allocation provision of the Emhart settlement agreement should be reversed and the matter remanded for the entry of an order approving the $7.5 million settlement absent any allocation provision, and (b) the District Court's order approving the Ilco settlement proposal should be reversed and the matter remanded with directions to permit discovery and hold appropriate evidentiary hearings, after proper notice to the class, on the financial responsibility of Ilco/Unican.

Respectfully submitted,

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August 17, 1976

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

IN RE MASTER KEY ANTITRUST LITIGATION EXXON CORPORATION, et al., Appellants.	Docket No. 76-7356

CERTIFICATE OF SERVICE

I, G. Joseph King, attorney for appellants in the above-entitled cause, hereby certify that on the 17th day of August, 1976, I served on appellees' counsel, Lee A. Freeman, Esquire, Freeman, Rothe, Freeman & Salzman, One IBM Plaza, Suite 3200, Chicago, Illinois, 60611; H. Laddie Montague, Jr., Esquire, David Berger, P.A., 1622 Locust Street, Philadelphia, Pennsylvania, 19103; Richard M. Reynolds, Esquire, Day, Berry & Howard, One Constitution Plaza, Hartford, Connecticut, 06103; and Charles Donelan, Esquire, Bowditch & Lane, 311 Main Street, Worcester, Massachusetts, 01608, two copies of the Brief For Class Members-Appellants and one copy of the two-volume Appendix, in accordance with Rules 25(a), 30(a) and 31(B), Fed.R.App.P., in the above-referenced appeal, by depositing the same in the United States mail, first class postage prepaid.